

## **Chapter 6**

### **Financial Protections**

#### **6-1. Introduction**

As previously mentioned, the SCRA can be thought of as providing procedural and substantive benefits. This chapter will discuss the remaining substantive benefits.

#### **6-2. Six Percent Interest Cap**

**a. The Statute.** The SCRA limits the interest on pre-service obligations through the following provision:

50 U.S.C. app. § 527

**(a) Interest rate limitation.**

(1) Limitation to 6 percent. An obligation or liability bearing interest at a rate in excess of 6 percent per year that is incurred by a servicemember, or the servicemember and the servicemember's spouse jointly, before the servicemember enters military service shall not bear interest at a rate in excess of 6 percent per year during the period of military service.

(2) Forgiveness of interest in excess of 6 percent. Interest at a rate in excess of 6 percent per year that would otherwise be incurred but for the prohibition in paragraph (1) is forgiven.

(3) Prevention of acceleration of principal. The amount of any periodic payment due from a servicemember under the terms of the instrument that created an obligation or liability covered by this section shall be reduced by the amount of the interest forgiven under paragraph (2) that is allocable to the period for which such payment is made.

**(b) Implementation of limitation.**

(1) Written notice to creditor. In order for an obligation or liability of a servicemember to be subject to the interest rate limitation in subsection (a), the servicemember shall provide to the creditor written notice and a copy of the military orders calling the servicemember to military service and any orders further extending military service, not later than 180 days after the date of the servicemember's termination or release from military service.

(2) Limitation effective as of date of order to active duty. Upon receipt of written notice and a copy of orders calling a servicemember to military service, the creditor shall treat the debt in accordance with subsection (a), effective as of the date on which the servicemember is called to military service.

(c) Creditor protection. A court may grant a creditor relief from the limitations of this section if, in the opinion of the court, the ability of the servicemember to pay interest upon the obligation or liability at a rate in excess of 6 percent per year is not materially affected by reason of the servicemember's military service.

(d) Interest. As used in this section, the term "interest" includes service charges, renewal charges, fees, or any other charges (except bona fide insurance) with respect to an obligation or liability.<sup>1</sup>

**b. Six Percent Interest Benefit Basics.** Just as the statute says, a servicemember can reduce interest on debts that existed prior to entry on active duty.<sup>2</sup> Even secured debts under a confirmed bankruptcy plan are subject to the benefit.<sup>3</sup> The benefit extends to cover debts jointly held with the servicemember's spouse. The point is to have the servicemember's payment reduced else there is little benefit. Although the servicemember must notify the creditor, the burden is on the creditor to show that the servicemember's military service does not materially impact her ability to pay the obligation.<sup>4</sup> "Interest" is broadly defined to preclude creditors from trying to collect the amount under another name. The interest is "forgiven," it is not deferred.

Under the prior provision, creditors often tried to hide the interest or to otherwise avoid the loss.<sup>5</sup> The current provision is straightforward. In comparison to the former provision,<sup>6</sup> the SCRA is abundantly clear. Nonetheless, it is important to be mindful of Congress' intent:

To resolve lingering questions about congressional intent, section 207 [50 U.S.C. app. § 527] (dealing with the maximum rate of interest on debts incurred before military service) would clearly provide that interest above the 6 percent rate is to be forgiven, and that the amount of the monthly payment is to be reduced. Not to forgive interest above the 6 percent maximum rate would place the servicemember in precisely the same financial dilemma Congress sought to ameliorate with the 1942 amendments. *See* H. Rept. 2198, 4 (1942). In addition, section 207 would clarify that joint debts between a servicemember and his or her spouse are entitled to the 6 percent interest relief protection.

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<sup>1</sup> 50 U.S.C.S. app. § 527 (LEXIS 2006).

<sup>2</sup> *Id.* app. § 511(2). For a discussion of the terminology of military service and active duty, *see supra* para. 2-2.

<sup>3</sup> *See, e.g.,* Baxter v. Watson (*In re* Watson), 292 B.R. 441, 444 (S.D.Ga. 2003).

<sup>4</sup> *Id.* at 445.

<sup>5</sup> *See, e.g.,* Major James Pottorff, *A Look at the Credit Industry's Approach to the Six Percent Limitation on Interest Rates*, ARMY LAW., Nov. 1990, at 49.

<sup>6</sup> *See* 50 U.S.C. app. § 526 (2000).

The original section provided no guidance on how the servicemember should initiate an interest rate reduction. The Committee believes the burden should be on the servicemember to inform the creditor of the order for military service within a specific time. Section 207 would codify the practices established during the Persian Gulf War. The servicemember would be required to submit to the creditor written notice and a copy of military orders. These orders indicate the period of time for which the servicemember is called to duty. If there is an extension of the military duty obligation, the servicemember receives amended orders and would be required to provide the amended orders to the creditor in order to extend further the 6 percent protection. The Committee notes that, while the section would allow for notice to the creditor of up to 180 days after the servicemember's termination or release from military service, it would obviously be of advantage to servicemembers to provide notice to creditors more quickly so that their monthly payments are reduced during the period of military service when their income may be reduced.<sup>7</sup>

**c. Six Percent Practical Considerations.** Despite the fact that the burden of proof is on the creditor to show that the servicemember's military service does not affect the ability to pay at the higher rate of interest, it may be in the servicemember's best interest to explain how the military service has caused a negative impact.<sup>8</sup> Normally, the key aspect of the inquiry will be into the servicemember's finances. It will not stop, however, with a review of the servicemember's income. There are times when a person will experience an increase in income because of a mobilization, but the financial situation will worsen. Members activated from the reserve components may find they have two households to maintain and that child care and other expenses have likewise increased.

During a reserve component activation, reserve servicemembers regularly invoke the protection. It should be noted, however, that the benefit also extends to new active component officers and enlisted personnel. Active component servicemembers seldom invoke the provision because the obligation must predate the active service. Additionally, any material effect is apt to be positive. The financial well being of officers fresh from college and enlisted servicemembers from high school is often enhanced. The opposite is often true for many reserve personnel who leave well-paying civilian jobs for less lucrative military assignments.

The benefit is only for those debts which existed prior to the servicemember's entry on active duty. Debts incurred following entry on active duty incur interest at whatever rate the servicemember contracts. Charges against a revolving credit account are at whatever rate the account is set up for.

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<sup>7</sup> H.R. REP. NO. 108-81, at 39 (2003).

<sup>8</sup> See *infra* App. B.

**d. Student Loans.** According to the Department of Education (DoE), the six percent interest cap is inapplicable to student loans.<sup>9</sup> The DoE conclusion is based on a section of the Higher Education Act of 1965<sup>10</sup> indicating that federal or state law limitations on the interest rate of a loan do not apply to guaranteed student loans.<sup>11</sup>

This does not mean that relief is not available to students called to active duty from the reserve components or for those who join the armed forces. Although a comprehensive discussion of student loan insurance and the provisions applicable to members is beyond the scope of this publication, it is worth noting that there are some statutory and regulatory provisions which provide for SCRA-like protection. For example, “[a]n institution shall cancel up to 50 percent of an NDSL [National Direct Student Loan] or Perkins loan for service as a member of the U.S. Army, Navy, Air Force, Marine Corps, or Coast Guard in an area of hostilities that qualifies for special pay under section 310 of Title 37 of the United States Code.”<sup>12</sup> Additionally, in accordance with the Higher Education Relief Opportunities for

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<sup>9</sup> Memorandum, Department of Education, subject: GSL Borrowers Adversely Affected by the Recent U.S. Military Mobilizations (Aug. 29, 1990).

<sup>10</sup> Pub. L. No. 89-329, 79 Stat. 1219 (1965).

<sup>11</sup> 20 U.S.C.S. 1078(d) (LEXIS 2006).

<sup>12</sup> 34 C.F.R. § 674.59 (LEXIS 2006). A servicemember is entitled to a month’s worth of special pay for any month that servicemember

(1) . . . was entitled to basic pay or compensation under section 204 or 206 of this title [Title 37 U.S. Code]; and

(2) the member----

(A) was subject to hostile fire or explosion of hostile mines;

(B) was on duty in an area in which the member was in imminent danger of being exposed to hostile fire or explosion of hostile mines and in which, during the period the member was on duty in the area, other members of the uniformed services were subject to hostile fire or explosion of hostile mines;

(C) was killed, injured, or wounded by hostile fire, explosion of a hostile mine, or any other hostile action; or

(D) was on duty in a foreign area in which the member was subject to the threat of physical harm or imminent danger on the basis of civil insurrection, civil war, terrorism, or wartime conditions.

Students Act of 2003 (HEROES Act)<sup>13</sup> DoE forbearance<sup>14</sup> rules, which allow for the forbearance on loan repayment, are waived for servicemembers<sup>15</sup> on active duty during war time.<sup>16</sup>

### **6-3. Fines and Penalties on Contracts**

50 U.S.C. app. § 523

(a) Prohibition of penalties. When an action for compliance with the terms of a contract is stayed pursuant to this Act, a penalty shall not accrue for failure to comply with the terms of the contract during the period of the stay.

(b) Reduction or waiver of fines or penalties. If a servicemember fails to perform an obligation arising under a contract and a penalty is incurred arising from that nonperformance, a court may reduce or waive the fine or penalty if----

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37 U.S.C.S. § 310 (LEXIS 2006).

<sup>13</sup> Pub. L. No. 108-76, 117 Stat. 904.

<sup>14</sup> “Forbearance means permitting the temporary cessation of payments, allowing an extension of time for making payments, or temporarily accepting smaller payments than previously were scheduled.” 34 C.F.R. § 682.211.

<sup>15</sup> The HEROES Act was obviously designed to benefit servicemembers, but it actual extends to protect a wider group known as “affected individuals” and defined as

an individual who—

(A) is serving on active duty during a war or other military operation or national emergency;

(B) is performing qualifying National Guard duty during a war or other military operation or national emergency;

(C) resides or is employed in an area that is declared a disaster area by any Federal, State, or local official in connection with a national emergency; or

(D) suffered direct economic hardship as a direct result of a war or other military operation or national emergency, as determined by the Secretary.

*Id.*, § 5(2), 117 Stat. 906-7.

<sup>16</sup> Notice of Waivers and Modifications, 68 Fed. Reg. 69,312, 316 (Dec. 12, 2003).

- (1) the servicemember was in military service at the time the fine or penalty was incurred; and
- (2) the ability of the servicemember to perform the obligation was materially affected by such military service.<sup>17</sup>

This section deals with two types of situations. First, when compliance with the terms of a contract is stayed pursuant to the Act, no fine or penalty shall accrue by reason of failure to comply during the period of the stay. Second, when no stay exists and a fine or penalty is imposed for nonperformance, the court can relieve enforcement if the person was in the military service when the penalty was incurred and his ability to pay or perform was materially impaired.

This section can be applicable to late charges on an installment contract, early termination penalties for an automobile lease with an option to purchase clause, or to a delinquency fine on a promissory note. In these cases, the court must conclude that the maker's military service impaired the ability to pay.

#### **6-4. Exercise of Rights Under Act Not to Affect Certain Future Financial Transactions**

This important section was added to the SSCRA in 1991 and remains in the SCRA:

50 U.S.C. app. § 518

Application by a servicemember for, or receipt by a servicemember of, a stay, postponement, or suspension pursuant to this Act in the payment of a tax, fine, penalty, insurance premium, or other civil obligation or liability of that servicemember shall not itself (without regard to other considerations) provide the basis for any of the following:

- (1) A determination by a lender or other person that the servicemember is unable to pay the civil obligation or liability in accordance with its terms.
- (2) With respect to a credit transaction between a creditor and the servicemember----
  - (A) a denial or revocation of credit by the creditor;
  - (B) a change by the creditor in the terms of an existing credit arrangement; or
  - (C) a refusal by the creditor to grant credit to the servicemember in substantially the amount or on substantially the terms requested.
- (3) An adverse report relating to the creditworthiness of the servicemember by or to a person engaged in the practice of assembling or evaluating consumer credit information.

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<sup>17</sup> 50 U.S.C.S. app. § 523 (LEXIS 2006).

- (4) A refusal by an insurer to insure the servicemember.
- (5) An annotation in a servicemember's record by a creditor or a person engaged in the practice of assembling or evaluating consumer credit information, identifying the servicemember as a member of the National Guard or a reserve component.
- (6) A change in the terms offered or conditions required for the issuance of insurance.<sup>18</sup>

This protection precludes negative fallout from a servicemember's resort to the Act's other benefits and protections. A basic protection would prevent a creditor, for example, from making an adverse entry on a servicemember's credit report because of the reduction in interest on a servicemember's debts to six percent.<sup>19</sup> As one can see, however, there are a number of other protections such as the prohibition against a denial of credit based on utilization of the Act and against discriminatory entries against members of the reserve components.<sup>20</sup> The benefits, in other words, extend to cover more than adverse credit reporting.

Of course, creditors may take adverse action against servicemembers who fail to comply with obligations after they are adjusted by reason of the Act. A servicemember who fails to pay monthly installments on an obligation reduced to six percent could be subject to an adverse credit report.

There are several ways to approach the problem when a servicemember receives an adverse credit report because he asserted one the SCRA's stay provisions,<sup>21</sup> the six percent interest provisions, or some other protection. Theoretically, one could institute a proceeding for injunctive or other equitable relief. A better method would be, in certain cases, to file under the Fair Credit Reporting Act (FCRA)<sup>22</sup> provisions for "adverse actions"<sup>23</sup>, handling disputed

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<sup>18</sup> *Id.* app. § 518.

<sup>19</sup> *Id.* app. § 527.

<sup>20</sup> *Id.* app. § 518(5). This portion of the statute is very interesting and carries with it an obvious linkage to the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). *See generally* 38 U.S.C.S. §§ 4301-33 (LEXIS 2006). This law works as its name implies: to ensure the continued civilian employment of those who are called to serve the nation through the armed forces. It also works "to prohibit discrimination against persons because of their service in the uniformed services." *Id.* § 4301(a)(3). *See also id.* § 4311.

<sup>21</sup> *See, e.g. id.* app. § 524 (stays or vacation of execution of judgments, attachments).

<sup>22</sup> *See generally* 15 U.S.C.S. §§ 1681-1681u (LEXIS 2006). *See also* ADMINISTRATIVE & CIVIL LAW DEP'T, THE JUDGE ADVOCATE GENERAL'S SCHOOL, U.S. ARMY, JA 265, CONSUMER LAW GUIDE ch. 9, at 30-64 (2004).

<sup>23</sup> 15 U.S.C. § 1681a.

information involving “adverse actions”,<sup>24</sup> and consumer remedies for “willful or negligent noncompliance by credit reporting agencies upon consumer showing of causal connection between inaccurate credit report and denial of credit or other consumer benefit.”<sup>25</sup> The definition of what constitutes an “adverse action” is rather broad, “[t]he term . . . has the same meaning as in section 701(d)(6) of the Equal Credit Opportunity Act [15 U.S.C. § 1691(d)(6)]”<sup>26</sup>, and defines an “adverse action” as “a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested.”<sup>27</sup> A servicemember who is refused further credit, or has his credit limit downgraded, and so on because of an SCRA assertion could obviously seek relief under this section.

### 6-5. Business and Trade Protection

One oft overlooked financial protection serves to protect a servicemember’s non-trade or business assets if the servicemember is personally liable on the notes from a trade or business:

50 U.S.C. app. § 596

(a) Availability of non-business assets to satisfy obligations. If the trade or business (without regard to the form in which such trade or business is carried out) of a servicemember has an obligation or liability for which the servicemember is personally liable, the assets of the servicemember not held in connection with the trade or business may not be available for satisfaction of the obligation or liability during the servicemember’s military service.

(b) Relief to obligors. Upon application to a court by the holder of an obligation or liability covered by this section, relief granted by this section to a servicemember may be modified as justice and equity require.<sup>28</sup>

The servicemember’s non-trade or business assets are protected while the servicemember is on active duty regardless of whether the military service has materially affected the servicemember’s ability to meet the obligation. It seems that the adverse impact of the military service on the trade or business and on the servicemember’s ability to meet the obligation is assumed.

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<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* § 1691(d)(6). It “does not include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default, or where such additional credit would exceed a previously established credit limit.” *Id.*

<sup>28</sup> 50 U.S.C.S. app. § 596 (LEXIS 2006).